

# The Public Liability Crisis – Why did it occur and how has it been resolved.

---

**Tom McDonald**

**School of Accounting, Economics and Finance**

**Deakin University**

**Melbourne Campus**

**Burwood**

---

## ***Abstract***

*This paper examines the cause and effect of the Public Liability crisis that emerged in the Insurance industry in Australia in 2000. It establishes the principal cause as inadequate premiums being charged by insurers in the preceding years combined with a rise in the cost of personal injury claims. In response to the crisis a range of initiatives were introduced, principally by the Commonwealth government, which are designed to assist the future predictability of losses and produce a more stable Public Liability insurance market. The full benefit of these initiatives will take some years to take effect but it would appear that the ultimate result will be a market that is charging substantially increased premiums from those applying in the 90's and a continuing difficulty for some industries to obtain cover.*

---

## **Introduction**

At the end of 2000 the media began reporting stories of social and sporting organisations being unable to obtain Public Liability Insurance or if they could, it was only available at prohibitive prices. Professional organisations were experiencing similar problems with very large premium rises being experienced and at times no cover available at all. From this flowed outcries from many sectors of the community to the extent that Commonwealth Government became involved.

This crisis had been coming for some years. Within the insurance industry there had been concern expressed at the unprofitable premium levels applying to public liability insurance. Some companies had withdrawn from the primary public liability market and others were not very active in the market being quite selective in the risks they were accepting.

The problem was hidden by insurer HIIH, who was very active in this area of the market and continued to provide very low premiums for public liability insurance when the market statistics were showing that these were unprofitable. In the period running up to its collapse HIIH were very actively increasing their market share in this class. We now know that these prices were maintained as HIIH had a need for cash flow to meet their mounting losses.

Since that time there have been a number of inquiries, reams of report produced in an effort to establish what the problem was and how it could be resolved.

In this paper I will attempt to address the following issues

- what was the problem;
- why the crisis occurred;
- what is the position today; and
- what is the result?

## **What was problem**

The problem that hit the public in 2000 was the sudden difficulty in obtaining public liability insurance. Whilst this problem was known in the insurance community for

some time it was hidden from the public as HIIH were still very active in providing cover at unprofitable prices.

The problem the public encountered ranged from a significant increase in prices to not being able to get cover at all. This effect was quite devastating for quite a number of insureds. It meant that some small businesses had to close, community groups had to cancel their fetes, fairs or activity days. The federal government held an inquiry into the crisis and a number of the affected parties made submissions. There were nearly 200 of these.

The removal of HIIH from the market revealed the problem. By March 2000 HIIH effectively ceased to be a force in the market. A number of insurers had in the preceding years withdrawn from this class of business and with the removal of HIIH from the market those remaining were able to charge a realistic premium for the risks presented. This had a dramatic effect on insureds. The occupations hardest hit were those that had large exposures to the public, for example hotels and licensed clubs, shopping centres, event organisers, sports organisers, tourism operators (Trowbridge, 2002), community events, retail industry and local government community groups (Senate, 2002). The effect on some of these was devastating. For some, amateur sporting and social clubs, as an example, the effect was such that they could no longer continue. This meant that a significant social service could not continue. The same happened with some small businesses. To indicate the extent and effect of the crisis one of the submissions to the Senate inquiry was from the Australian Injecting and Illicit Drug Users League who provide clean needles for drug users. The effect for them was they were no longer able to obtain public liability insurance which in turn meant that they were not able to continue their service (2002).

The insurance market has experienced peaks and troughs before that have created premium rises but this time the upward swing was very great and was creating significant hardship in the community.

## Why the crisis occurred

From a review of the various reports and submissions to the Senate inquiry the following points emerge as the cause of the crisis.

- a ‘hardening’ of the insurance market was necessary, after a period of underpricing and poor profitability in the mid 1990s, and insurers needed to focus on improving profitability rather than merely increasing market share;
- the increasing cost of claims; and
- international influences including the withdrawal of capacity and the increasing cost of reinsurance following the destruction of New York’s World Trade Centre in terrorist attacks on September 11, 2001.

In considering these aspects in more detail the following points will be addressed:

- The insurance cycle
- Inadequate premiums
- Claims cost
- Status of the law and
- Increased statutory requirement.

### *Insurance cycle*

The insurance market historically goes through a cycle that ranges from a very soft market to a hard one. The cycle varies but usually lasts about 5 years. The market will emerge from a period of high rates and strict underwriting as insurers return to profits and then endeavour to increase their market share. In doing this, competition drives premiums down producing a soft market to be enjoyed by the buyers. Inevitably the losses will send profits from the reduced premium tumbling leading the insurers into a hard market when they consolidate their position only to emerge on the cycle once again when profits return. The diagram in Figure 1 below provides a more detailed explanation.

Relating the cycle to the insurance market in the 90’s we find that through the 90’s the insurance market was very competitive. Investment returns were also very good which hid what was happening in the claims area. By the mid 90’s premium rates for liability insurance began to drop and by 1998 insurers were starting to take action by

- increasing premiums resulting in the loss of market share
- cut back the amount of business they were willing to write and
- withdrawing from the market of some insurers such as AIG, St Pauls and AGR.



**Figure 1 The Insurance Market Cycle**

*Source: Trowbridge, 2002*

HIH and FAI were the primary competitive forces and both, we now know, were seeking cash flow. They were regarded as the main forces in reducing the rates and keeping them down until 1999.

The hard market then began to take over. By June 2000 rates began to rise. In the latter half of 2000 HIH, who had already taken over FAI, had sold their small commercial policies portfolio to Allianz and large commercial policies portfolio to QBE which effectively removed HIH from the market. A provisional liquidator was appointed to HIH in March 2001. The remaining insurers became very conservative (did what they always wanted to do) and wrote business at a profit. Since 2001 the market has not chased this business. QBE selectively renewed business, an approach used in the past to weed out a portfolio and make it profitable. The approach since 2001 has been to accept business at a reasonable price otherwise decline it. An example of changed attitude is seen in the action of one major insurer who advised the Senate inquiry that in 1999 very few surveys were made compared to 2001 where some 600 surveys were undertaken (Trowbridge, 2002). By conducting surveys an insurer is taking a much stricter approach to underwriting.

### ***Inadequate Premiums***

Public Liability insurance can be a difficult class of business to underwrite. Because of the delay in the settlement of bodily injury claims the amounts that are finally paid are not known until some years after the year in which the premium was paid. This makes it difficult to see where there is a pattern of increasing losses. A further complication lies with changes in the law either through legislation or through changing common law decisions that can result in an altered loss pattern from that which existed in the past. When considering the premiums and losses over the 90's it is apparent that the premiums have been underpriced for most of that period. Throughout the 90's investment returns were good and these softened the impact of the losses being suffered. When the investment returns began to fall, the losses suffered climbed considerably.

With the events of 11<sup>th</sup> September 2001 reinsurance costs rose dramatically. With public liability business, the type of reinsurance used is primarily 'excess of loss' reinsurance. This means that the reinsurer will only be involved in very large losses. Prior to September 11 the reinsurance costs for public liability averaged about 10% of the premiums. September 11 increases were around 25%. This meant that the 10% increased by 2.5% to 12.5%. Such an increase would have had little effect on the premium increases.

A barrier to premium increases was HIH which was a combination of many insurance companies. Its Managing Director, Ray Williams started a company in 1969 under the name of Michael Payne Liability Agencies. The company specialised in workers compensation and public liability insurance. This company grew, took over and merged with other companies until it became HIH in the 1990s. They always remained a significant force in public liability insurance. HIH adopted a very aggressive approach to the pricing of public liability insurance. In the late 1990s when some companies started to withdraw from this area of the market and others correctly priced their risks in order to produce shareholder returns, HIH continued their aggressive approach which produced a steady increase in their market share. They acted as the market "cut price" insurer (Trowbridge, 2002).

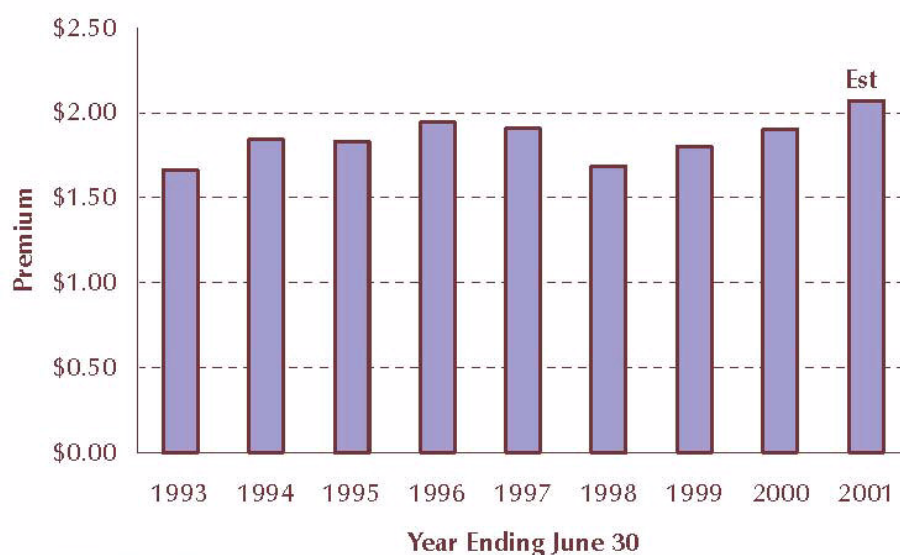
In a survey of the public liability market by ACCC (2002) as part of their monitoring role, the respondent insurers said that the demise of HIH did not affect their premium rates - in other words they did not increase them. They already had higher rates and HIH was taking

the business from them. We now know that during this time HIIH was badly in need of cash flow and were using aggressive rates to capture this.

In the period leading up to the demise of HIIH there was quite an amount of merger activity. At this stage APRA had signaled its intention to strengthen the minimum capital requirements and this may well have precipitated some of the mergers. The consolidations in the market place meant that a larger percentage of the market was in fewer hands and these hands acting more responsibly.

A point to keep in mind is that Public Liability insurance comprises only 6 -7 % of the total insurance market but it has very significant effects on the community. It provides cover to meet the liability of insureds that can run into millions.

The graph in Figure 2 below shows the growth in premiums against the GDP, in other words growth in real terms. From 1993 to 1996 the growth is small. From 1996 to 1998 there is a steady decrease. By 1998 the effects of the inadequate premiums were being felt and in 1999 the premiums started to rise and by 2001 had reached the level they were at in the mid 90's.

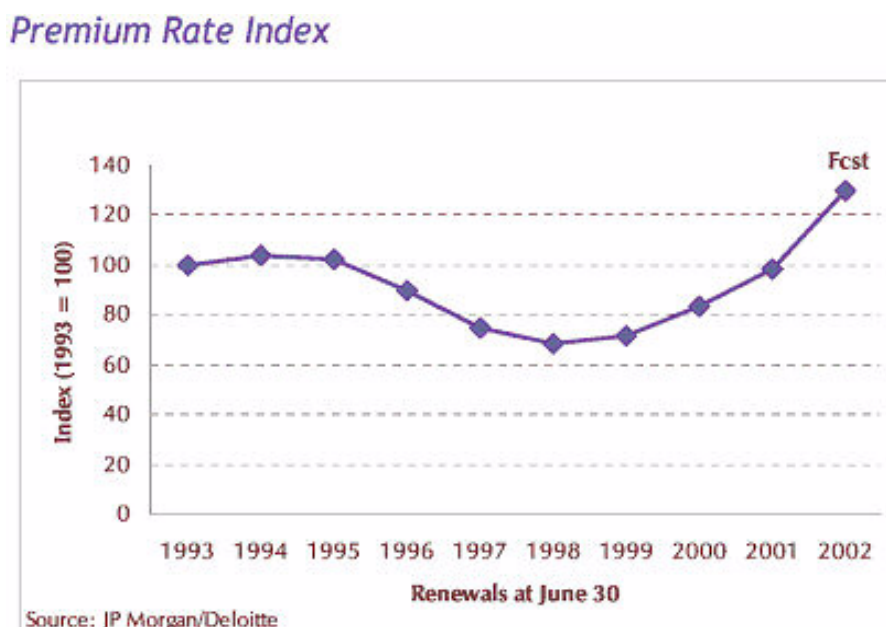


Source: APRA Selected Statistics

**Figure 2 Liability Premium per \$000 GDP (Trowbridge,2002)**

### *Insurer profitability*

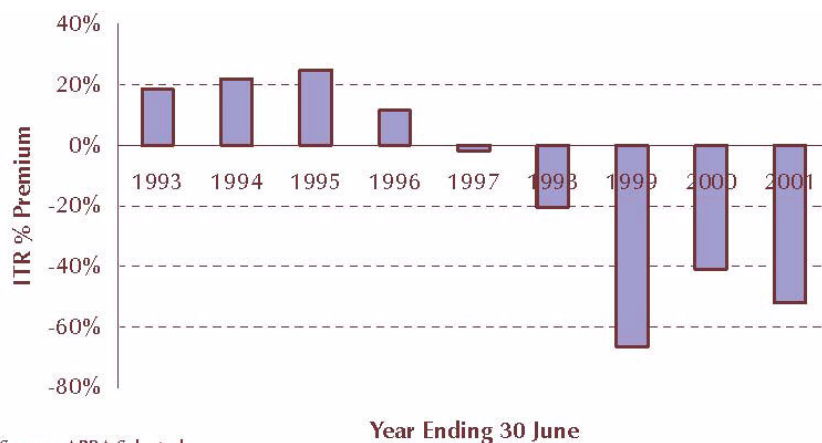
In an annual survey conducted each year of insurers and brokers their estimates of premium rate changes are sought and are shown in the index set out in Figure 3 below (Trowbridge, 2002).



**Figure 3 Liability Premium per \$000 GDP (Trowbridge, 2002)**

Whilst this shows the movement in rates, of more interest is the profitability to insurers in this class. As mentioned earlier the insurers' inadequate premiums were being supported by investment income. One of the features of this class is that there is quite a delay in the payment of bodily injury losses. The reserves set aside for these losses are invested, principally into fixed investments. In considering the profitability this investment income needs to be brought into account. Figure 4 below is derived from APRA data which is based on accounting conventions. These require that results be reported on an annual basis. In the case of claims, particularly public liability where losses are not finalised for many years, one particular loss can be shown across the accounts of several years. As an example, a severe bodily injury loss is reported in year 1 and a provision of \$500,000 is made. In year 2 further information comes to light and that estimate is increased to \$800,000. In year three because of a new court decision it is now possible to claim further amounts so the estimate is increased to \$1,000,000 and the claim is settled for that amount.





**Figure 4 Insurer profitability using APRA data (Trowbridge,2002)**

The example is simplistic but will illustrate the point. The loss that occurred in Year 1 when the premium was assessed and paid is \$1 million. It has been shown in the

accounts as

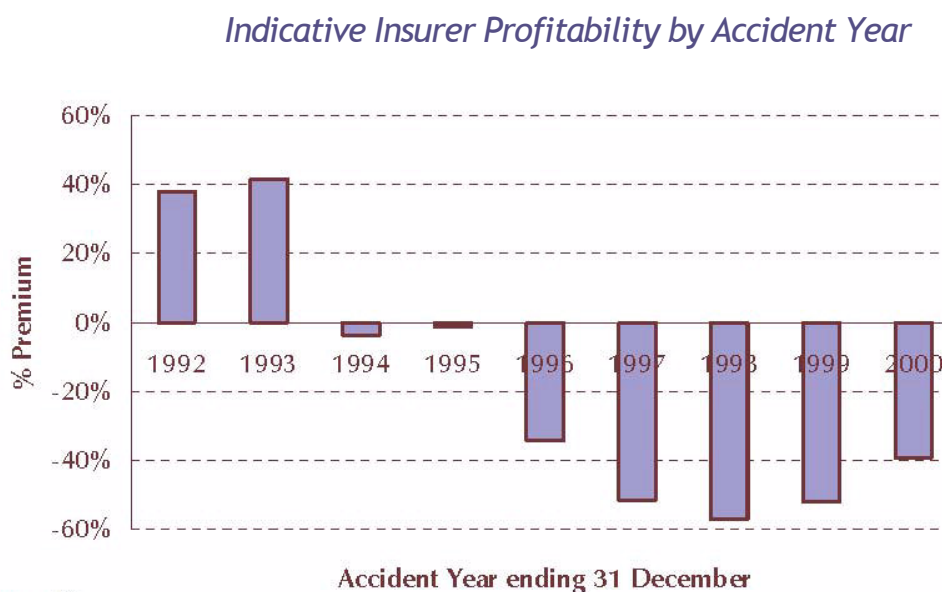
Year 1	\$500,000
Year 2	\$300,000
Year 3	\$200,000

To make a valid comparison of the premium and losses it is necessary to compare the premiums for a particular year with the losses for that year. Using the accounting approach the picture given is a very misleading one.

Figure 3 shows the insurers trading result over an 8 year period. The loss for 2001 would have been greater as the HIH figures are not included. The results shown do not show the true picture for any one year. The loss deterioration shown from 1997 onwards in fact occurs in part as a result of increases to reserves from prior years that are only being recognised in the latter years of the 90s. This is not the result of insurers being lax in their reporting but has come about because information relating to losses is delayed particularly in relation to personal injury losses.

In encountering this problem, Trowbridge (2002), has access to data produced by Insurance Statistics Australia (ISA). This is a statistical group who act for a number of insurers in the marketplace (10 – 20%) by collecting, combining and analysing their data and returning certain statistical factors back to them to assist them in setting rates. This data is more extensive than APRA's data. From this data Trowbridge (2002) was able to produce a graph where premiums and losses for the same year are compared – referred to a 'date of accident basis'. The same period covered in Figure 4 above is set

out in Figure 5 but on a date of accident basis as this provides a more objective picture of what is actually happening. This shows 1992/3 as being profitable, 1994/5 as marginal and 1996 onwards as being very unprofitable. Keep in mind that by 1998 insurers were withdrawing from the market. It was not until 2001 that the effect of the remedial action taken was starting to take effect, when HIIH was removed from the market.



**Figure 5 Insurer profitability – date of accident basis (Trowbridge2002)**

### ***Claims cost***

For several decades and in a range of different insurance covers involving bodily injury there has been ‘real increases’ in the cost of personal injury claims. There appears to be two main reasons:

- increasing propensity to make a claim following injury
- higher compensation to people for a given type or severity of injury.

A range of reasons have been put forward to explain this in submissions to the Senate inquiry and these covered:

- Changing community attitudes. People in the past accepted the result of misfortune but today there is the expectation that society should look after them. This comes with the willingness to institute legal actions for

compensations. (Trowbridge, 2002).

If society accepts this shift then there is a consequence. This change comes at a cost and it needs to be prepared to meet that cost. The problem lay with insurers not passing on this cost in a more gradual manner.

- Plaintiff law firms who specialise in personal injury cases have had the effect of increasing claims in this area through wide advertising and running test cases. The point is that regardless of whether this is right or wrong it is a further reason for the increase in losses. If society feels the cost should be met then they must bear the cost of it.

There are several issues that need to be considered in relation to the cost of claims. These can be summarised as:

- Type of losses, and
- Cost of losses

#### *Type of losses*

There are two types of claims in public liability, bodily injury and property damage.

Indicative figures for the mix of the claim types across the whole of public liability are:

	<b>Ppn by Number</b>	<b>Average Size</b>	<b>Ppn by Cost</b>
Property damage	75%	\$5,000	35%
Bodily injury	25%	\$25,000	65%

**Figure 6 Public Liability – Distribution of loss types. (Senate, 2002)**

Source: Senate, 2002

Most property damage claims are settled within one or two years. Whilst the table above shows an average size of \$5000 they have the potential to run to millions of dollars.

Consider the ship that ran into the bridge on the Derwent river in Hobart bringing down the bridge, the cost many millions. A crane in Western Australia on a wharf that failed – Cost \$6 million.

Bodily injury losses are fewer in number but are much larger in cost. They take longer to settle as it often takes two years for injuries to settle and the extent of an injured persons disability become known. They can take 3 – 5 years to settle.

The cost of claims has been rising for many years driven by personal injury losses. The rate is more than 10% per annum and has probably been rising for more that 20 years.

### *Cost of losses*

The rising cost of claims is not a new phenomenon. The increase has been greater than the inflation rate for the last 20 – 30 years. To find the cause of this rise it is necessary to examine several areas. These are

- Frequency of losses
- Severity of losses
- Loss provisions

### *Frequency of losses*

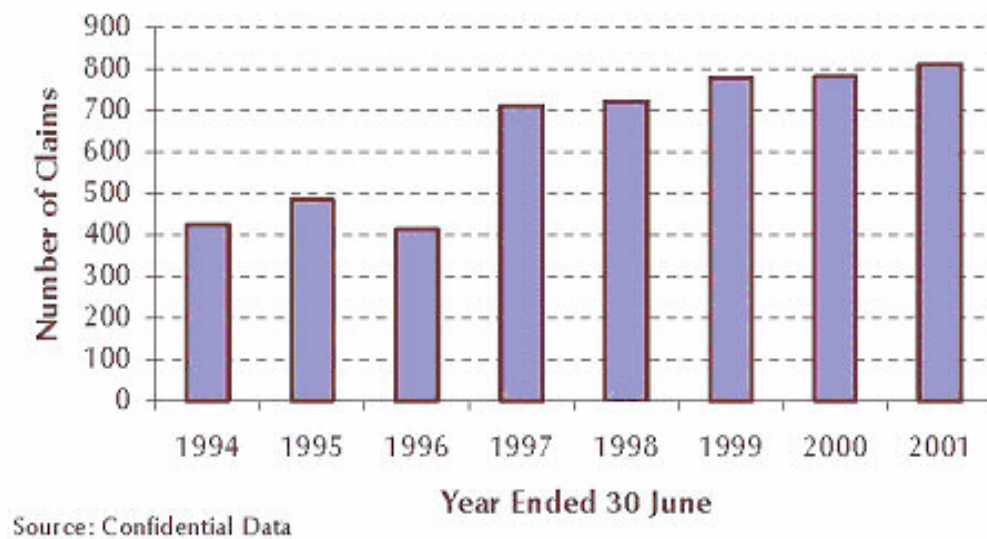
In the analysis several submissions pointed out (Trowbridge 2002) discrepancies in the APRA data in relation to the number of reported claims. This information was rectified by APRA but there were lingering doubts. In examining this area Trowbridge examined the data from ISA, shown in Figure 7 and some other insurers and concluded that whilst the ISA data has limitations there is sufficient information to reasonably conclude that the number of claims has varied little but there has been some reduction in the number of claims in 1999 and 2000.



**Figure 7: Estimated Claim Frequency per \$100,000 Premium for ISA Contributors (Trowbridge 2002)**

The data appeared to indicate a shift in the ratio of property damage losses to bodily injury losses with growth occurring in the bodily injury claims. Also the reduction in claims in recent years may well be the result of excesses rather than a reduction in the occurrence of incidents.

Where data for a local government group was examined quite a different pattern emerged. This can be seen in Figure 8 which shows a sharp increase in claims made on councils beginning in 1996 and increased steadily since.



**Figure8: Number of claims for a local government Group (Trowbridge 2002)**

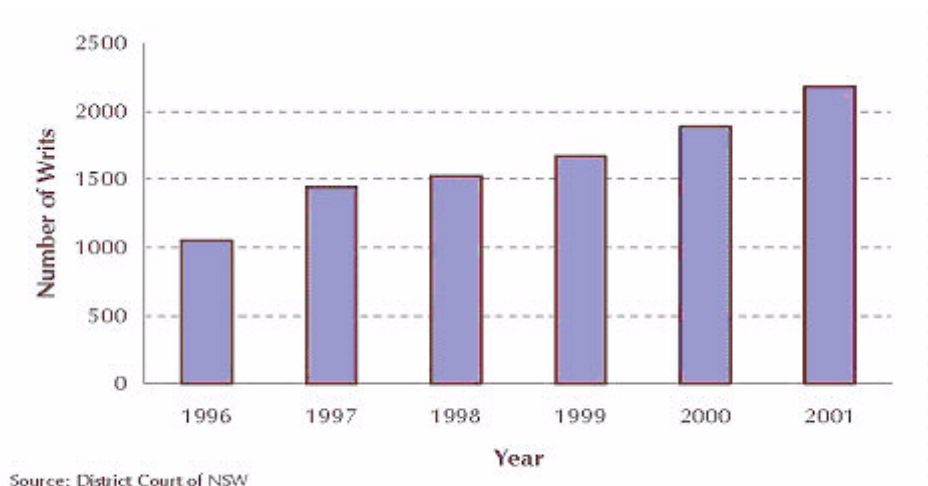
This points to the necessity to obtain better data, for whilst one picture is shown by the combined data, segmented analysis would most likely reveal quite a different picture for specific industries.

One of the 'causes' given for the deteriorating loss position was the increase in litigation. Insurers rarely take a claim to court. The vast majority are settled out of court. To take a case to court can be an expensive exercise and they look to avoid this cost. This does not mean that litigation is not a problem. Those cases that do go to court establish principles that are used in other cases that are settled without recourse to the courts. The court decisions expand the law, that expanded principle is applied to the other cases awaiting settlement. One decision affects many cases. It is the collective volume that needs to be kept in mind when considering the effects of litigation increases.

Insurers do not record the cases that go to court and courts, generally, do not record when a case involves public liability. The suggestion that there has been an increase in this area is based on anecdotal evidence. This seems to be coming from

- Class actions— Wallis Oyster, Peanut butter, contaminated Metwurst, World Hot Bread bakery (Salmonella)
- Contingent fees – no win no pay
- Solicitors advertising for businesses in newspapers and radio
- Stricter liability in some areas – limited available defense available
- Generous verdicts given by some courts.

In seeking to verify this claim Trowbridge (2002) found that the NSW District court was able to identify and extract information on public liability cases lodged in the Sydney region in recent years.



**Figure 9 Public Liability writs lodged Sydney District Court (Trowbridge 2002)**

Figure 9 shows that there has been a consistent increase in new public liability matters brought before the court. Specifically the data showed that the number of cases brought over the period covered had doubled and was increasing at the rate of 15% per year.

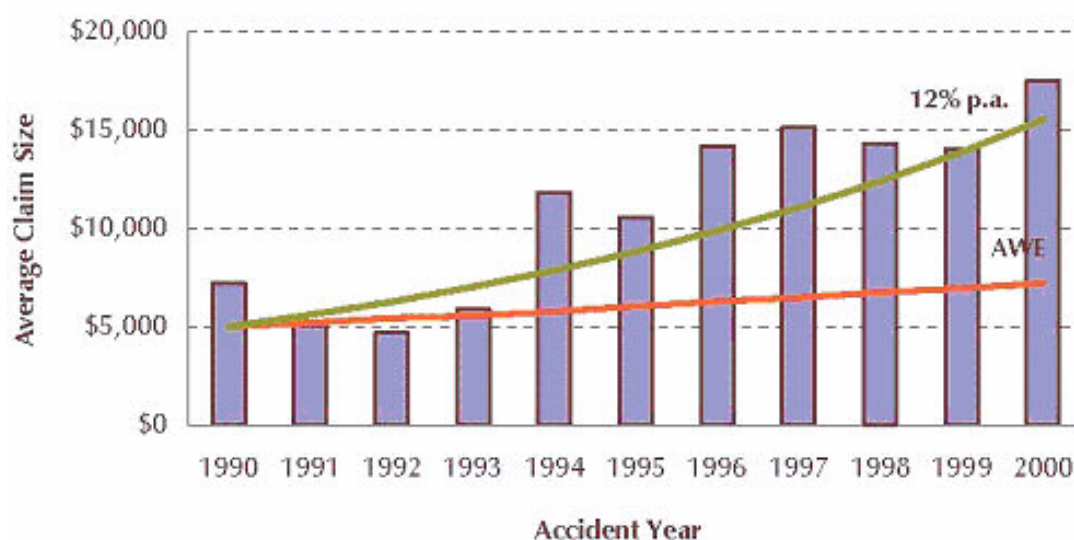
There are a couple of caveats that need to be placed on this data. First is that Sydney has the dubious honor of being the litigation capital in Australia and secondly that in 1997 the limit placed on the court regarding the cases they could hear was lifted from \$250,000 to \$750,000. Despite this the graph clearly shows a steady increase in litigated cases and it is

reasonable to expect that other states were showing an increase in litigation, possibly not to the same degree

### *Average Cost Per Claim*

Mention was made earlier of the problem associated with establishing the number of policies issued and the number of claims reported in the APRA statistics. Once again the ISA data has been used in the analysis here.

Figure 10 shows the claims on an 'accident year' basis. This means that all payments and outstanding claim estimates relating to a particular claim are shown in the year that they occurred. This allows a more accurate picture to be obtained and enables a more accurate analysis of risks.



Source: ISA

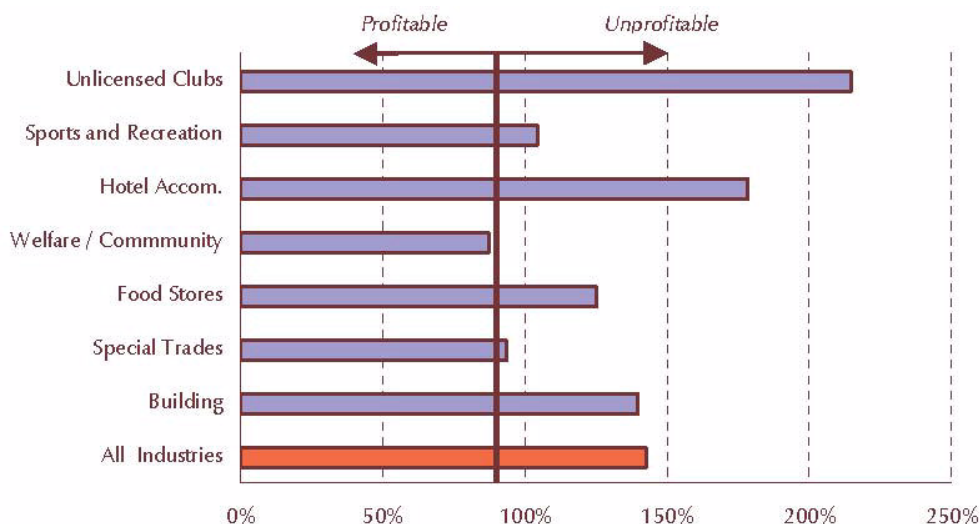
**Figure 10 Estimated Average Claim size for ISA Contributors (Trowbridge 2002)**

The graph shows the average claim size compared to the average weekly earning and also a line showing the level that represents a 12% pa increase. The average would be in the vicinity of 10% per annum and would be about 5% pa above the average weekly earnings amount. Trowbridge (2002) were able to access the data of two other insurers that provided, separately, data on property damage and bodily injury. They found that whilst there was no change between years for the average property damage losses there were significant increases for bodily injury losses.

A problem with the data has been a lack of detailed information. Greater insight can be obtained by considering data from other sources. The Insurance Council of Australia (ICA 2002) in their submission provided collective information from five insurers on claim costs from 1993 to 2001. The analysis showed that over that period the average claim size doubled and the increase was not due to large claims but was uniform across all size claims.

### *Specific Industry data*

The APRA data is collected for the purpose of establishing the solvency of insurance companies. The information provided to APRA does not breakdown into specific industries but shows only the position for each class of business viz Fire, Public Liability, etc. It may show that a specific class is unprofitable but it will not be known if this applies to all industry groups in a class or is related to specific areas only. The ISA data is more extensive and enables an analysis by industry segments. The industries are very broad and cover only the years 1994 – 1998 and the results are given in Figure 11



**Figure 11 Estimated ISA Loss Ratio 1994-1998 by Industry Segment (Trowbridge 2002)**

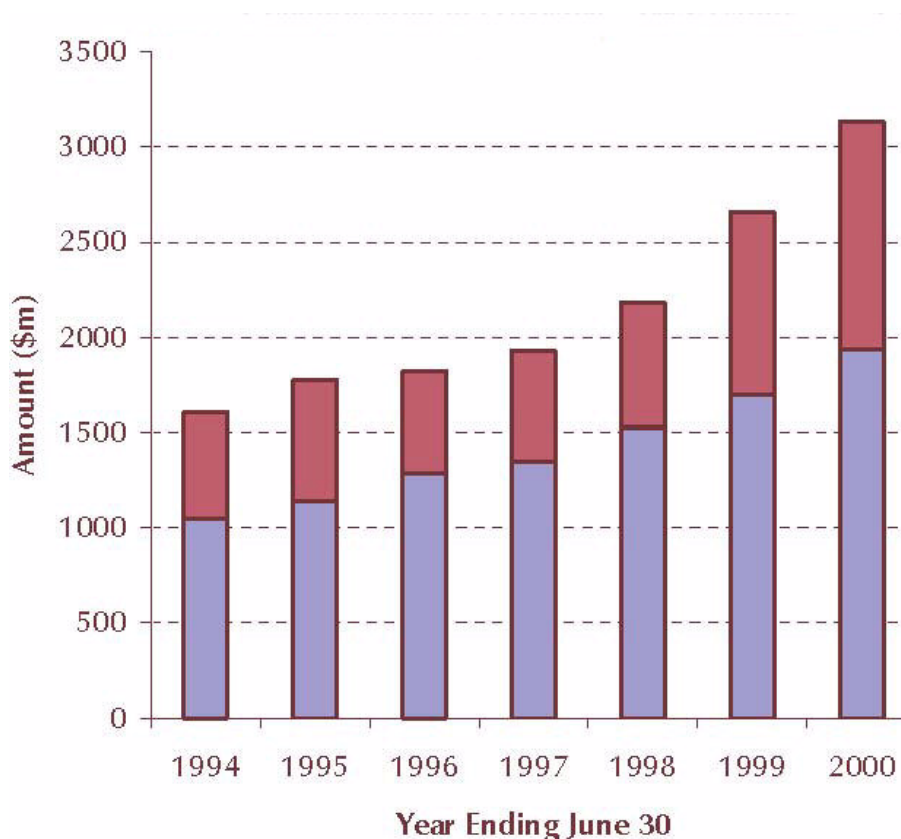
The result indicates possible problem areas but indicates more detailed recording of information is needed. In the days of the Fire and Accident Underwriters Association (forerunner of the Insurance Council of Australia (ICA)) this detailed information was recorded by the industry. With the advent of the Trade Practices Act the monopoly was disbanded and continued as a voluntary association as the ICA. By the early 80s the Trade Practices Commission (TPC) now Australian Competition and Consumer Commission



(ACCC) indicated that the continued reporting of information to members and provision by the association of advisory rates and wordings still meant that ICA was operating as a monopoly so the result was that this information dissemination ceased and the information was no longer gathered from insurers. Something that is now said to be essential – and it is.

### *Loss Provisions*

When a loss is reported its ultimate cost is first estimated by the claims officer on a case basis based on the information available at the time. As more information becomes available these estimates are adjusted. Over and above this there are portfolio wide provisions made for two areas IBNR (Incurred but not reported) and RBNER. Reported but not enough reserve). The setting of these provisions is based on the past patterns that have occurred in each of these areas and for anticipated future trends. Company management makes the final decision based on the first two steps as to what amount is included in the annual accounts.



**Figure 12: Composition of Provision - Case Estimate and Total Provision**  
Case estimates lower bar additional provision upper bar

Figure 12 shows the results of these two steps using APRA data which is on a year of accident basis. This means that the increases shown that rise more rapidly in the latter

years may in fact be increases on losses in earlier years. The additional provision increased slowly from 1996 to 1998. The total provision expressed as a multiple of case estimates increased reduced from 1.54 in 1996 to 1.43 in 1998. In 1999 and 2000 the provision increased steeply to 1.62 of the case estimates

#### *Adequacy of data*

The availability of good data is essential for all classes of insurance and in particular public liability Insurance. To establish trends, data over a long period, 5 – 10 years, is needed. On the basis of the data available at present we can conclude that

- Insurers are making a loss and
- Losses are rising faster than the inflation rate

beyond that conclusions cannot be drawn due to limited data.

In the past there was extensive data collected by the ICA but the impact of the Trade Practices Act in 1974 and then the later edict the TPC that the provision of advisory wordings and tariffs was in breach of the Act forced the ICA to stop collecting statistics.

In the report “Lack of Industry Data” (McCarthy, 2001) concludes that insurers need to improve their data collection. This is an expensive and time consuming task and since the demise of the ICA data collection there has not been an industry wide collection of data. The Trowbridge report and the Senate report recommendations both advocate that the role of APRA should be extended to include the collection of the necessary data on behalf of the industry.

#### **Status of the law**

The law strikes a balance between the need to protect the community and at the same time allow business to grow and develop. If the balance moves too far in either direction the consequence is that either:

- business will move its capital to other less risky areas and the community will suffer from a lack of development in that area, or
- the public (individuals) will suffer through injury and damage incurred.

Over time this balance moves more in the direction of improvements as business through being able to absorb the associated costs of risk management practices and meeting the cost of risk. At times the law progresses too fast. An insurer is simply the manager of a pool. Premiums are assessed on the losses that it is estimated the pool will need to meet. Losses are paid from the pool. Premiums are adjusted to meet the future estimates based on the past experience. If insurers assess the premium correctly there will be sufficient funds in the pool to meet the losses. If they collect insufficient premiums then they have to make increases in future years and meet the shortfall from shareholders funds.

The results in 2002 occurred because the incurred losses exceeded the premiums. For ten years insurers had been charging inadequate premiums. In 2002 premiums were increased to correct levels which meant, compared to previous years, a very large increase.

One of the problems that has emerged is that in some areas the expansion of the law has been too rapid producing a situation where the cost of losses is becoming too difficult to predict and it appears will be producing premiums that will be too great for the public to afford. With this in mind the Senate in their report following their inquiry concluded that the following areas of law need to be reviewed:

- Move the definition of negligence from strict liability to reasonable person approach. Courts have moved more to a strict liability reducing the opportunity to defend actions.
- Tort reform to reduce damages compensation by
  - introducing a threshold for general damages
  - implementing a cap on general damages, loss earnings and medical
  - restricting certain heads of damages such as care by family members
- encourage structured settlements for catastrophic settlements
- reform legal system to reduce cost and amount of litigation by
  - controlling legal advertising
  - regulating legal fees

By increasing deregulation of legal fees, contingent uplift fees and 'no win no fee' arrangements a greater number of people have had access to the courts than before as they could not afford it (which is good) but the cost must be borne by someone.

- Class actions– high profile cases involving food contamination and the like is one of influences in increasing costs and changing attitudes. In US there are moves to restrict the use of ‘class actions as their use is moving beyond the initial intention.
- In other areas of liability insurance similar problems emerged several years ago, specifically Workers compensation and Compulsory Third Party(CTP) insurances. These problems were addressed by imposing restrictions such as limiting the amount of damages that can be claimed, setting minimum thresholds and, in some states the abolition of the right to sue. The setting of these limits needs to be common across all areas (Workers compensation, CTP and common law) to ensure fairness and deter plaintiffs seeking avenues to bring claims in different forums. For example a Contractor whose work situation may allow them to claim they are employees (or the reverse) if there is an advantage to be gained.
- change no win no pay arrangements
- change uplift fee arrangements
- increase the risk involved in unsuccessful litigation through cost arrangements
- mandate alternative dispute resolution systems.
- Exempt certain volunteers and organisations
- Use industry standards as a defense in claims
- Injuries to volunteers and contractors cover under Workers Compensation
- Allow waivers for inherently risky activities

The focus of these areas was principally on personal injury. There are a range of matters that contributed to the Public Liability crisis, one of these being the increase in the cost associated with personal injury claims in the preceding years. The extent of this is best demonstrated by comparing the average inflation rate over the 10 years to 2002. The Trowbridge report indicated an average increase in the personal injury awards of 10% per annum which is several times the average inflation rate during that period. When considering the position with large claims the picture is bleaker showing that between 1979 and 2001 the CPI has increased by 212% yet in the same period the largest personal injury award has risen from \$270,000 to \$14.2 million an increase of 5000%.

Following the Senate report, on 2 July 2002 the terms of reference were set for an expert panel to be chaired by Justice David Ipp into ‘the application, effectiveness and operation of common law principles applied in negligence to limit liability arising from personal injury and death’. This included among other things a review of the standard of care, contributory negligence, and the assumption of risk. The terms were set from a ministerial meeting comprising ministers from the federal government and all state and territory governments and a representative from local government. This was necessary as the resulting recommendations would require a uniform approach by all level of government. If a uniform approach was not adopted then it would leave the way open for forum shopping.

In addition the panel was to consider options

- to limit and quantum of awards for damages.  
Consider the principles of negligence to limit liability in relation to public authorities
- Develop proposals to allow the self assumption of risk  
Restrict circumstance in which a person must guard against the negligence of others
- Replace joint & several liability with proportionate liability
- Develop options to limit or limit liability of eligible not for profit organisations from damages claims for personal injury or death (other than intentional torts)
- Review the Trade Practices Act with the common law principles applied in negligence particularly in respect of waivers and voluntary assumption of risk.
- Examine a 3 year period for the limitation of personal injury actions.

The result of the review was the “Ipp report”. The key recommendations of this report were agreed to by the fourth ministerial meeting.

Over the period of these Ministerial meeting there were a range of other measures agreed to that would assist with resolving the crisis. Briefly these were:

- Structured settlements. These were seen as being beneficial to the injured party as they provided greater security than one-off lump sum settlements. This could arise if the lump sum was mismanaged the injured person is left without financial support. The insurer benefits from meeting damages that are more closely aligned with the injured party's needs.
- Legislation that allowed people in specified circumstances to a voluntarily waive their right to sue.
- The ACCC were commissioned to monitor premiums for liability classes of insurance.
- The collection of more meaningful data by APRA for liability classes was also implemented.
- The Productivity Commission undertook a study to establish a benchmark for claims processing
- Ministers agreed to legislate to protect certain volunteers from being sued.

The reforms to the law, which have been implemented in most jurisdictions, grouped into three types (Coonan, 2004):

- Establishing liability. This relates to changes to the law governing decisions on liability including contributory negligence and proportionate liability.
- Damages – changes to the amount of damages paid to an injured person for personal injury.
- Claims procedures. This area cover time limits, court proceedings, legal conduct and legal costs.

As far as Public liability insurance is concerned the main focus of these reforms is on personal injury losses. This next section will expand on each of these reform areas.

***Establishing liability*** – The Ipp report saw a need to provide statutory guidance to courts on the way matters such as duty of care, foreseeability, causation and remoteness of damage are decided. This has now been implemented on a uniform basis in most states and territories.

There have also been changes made in the law to allow for the assumption of risk by the parties involved in an inherently risky activity and changes also to the manner in which liability is apportioned. This has been permitted in relation to those businesses in the recreational area and community groups where waivers can be signed by participants. This allows them to participate in the activity and in return they will bear some of the risk for their own safety.

***Damages*** – These reforms have focused on removing small claims and placing a limit on large losses. There has been growth in medium sized bodily injury losses during the 90's and the reforms are aimed at eliminating these. Quite recently in Melbourne there was a food poisoning incident at a restaurant which affected some 400 people. Whilst the incident was unpleasant and uncomfortable for those involved with the reforms introduced in Victoria the people affected will not be able to seek damages. Previously this would probably have resulted in a class action. Most jurisdictions have now implemented thresholds to eliminate these small claims.

The other area of concern is in relation to large claims which seem to be continually increasing. Whilst it is not being suggested that these claims are being treated to generously it does have the effect of raising the potential risk for the insurers. This could reach a point where the setting of rates becomes too unpredictable and insurers would not participate in the market. Keep in mind that this class of business comprises only 7% of the total market in Australia. In most states caps have been placed on claims for loss of earnings and for general damages (pain suffering and non economic losses).

### ***Procedural reforms***

These have been implemented in all jurisdictions and comprise areas such as limitation periods, pre-litigation procedures, plaintiff lawyer advertising, and the proportion of the award consumed by legal fees.

In all there have been quite extensive reforms undertaken however these relate principally to personal injury claims. These it must be remembered take some years to settle. In many cases the effects of these reforms will take some years before their full effect will be reflected in the statistical data. For example the minimum thresholds that have been set will stop smaller losses being accepted. This will have an immediate effect on new losses

occurring. Caps on the amounts claimed will have an immediate effect on major injuries. There will however be very few of these. The balance, which would represent the majority of the losses will take some years for the full effect to be felt.

### **Increased statutory requirements**

From 1 July 2002 APRA introduced new Minimum Capital requirements that bring into account the riskiness associated with each class. These new requirements brought with them compulsory risk management requirements which would include underwriting and pricing controls. The effect of this in 2001 would have produced a more conservative attitude to accepting risks and the premium levels applied. Insurers need to more actively manage their capital requirements. Some are placed premium caps on class portfolios. As premium rates increase the capital backing also needs to increase. This gives stronger capital backing but it also means more funds are needed. The new capital requirements require that in relation to claims a capital charge of 15% on net claims provisions and 2% on reinsurance recoveries from grade 1 & 2 reinsurers. This can have an effect on the limits offered due to the demand on an insurer's capital.

These additional capital requirements when added to a class of business that has a deteriorating loss ratio and rising claims costs along with court decisions that are increasing breadth of liabilities in both areas of liability and quantum would produce a conservative approach in any prudent insurer.

### **What is the position today?**

Most industry sectors can now obtain access to public liability cover, the difficulty is mainly associated with price. Community groups in particular maintain that the cost is beyond their ability to meet the premiums. Premiums are still increasing but at a much reduced rate. More insurers are returning to the market but the market generally is adopting quite a cautious approach looking to see the effect of the reforms which will not be known for some time.



A criticism that is emerging relates to the release in recent times of very healthy profit results from the industry when there is no corresponding reduction in public liability premiums. The answer is that these profits have not come from the public liability business but from other classes of business. Keep in mind that public liability insurance accounts for only 6 - 7% of insurers income. Many insurers do not provide this cover or are not involved in this market to any great degree. The problem in the past was that inadequate premiums were being charged. Insurers are seeking to rectify this and charge adequate premiums to ensure a stable public liability sector for the future.

The result is that this is still a 'work in progress'. Several factors combined to give the industry a huge wakeup call.

- The loss blowout in relation to liability insurance,
- the new regulatory requirement,
- the consolidation of the insurance market, and
- the public dissatisfaction with the regulator APRA.

These factors have produced a new and more conservative approach by the industry and the regulator. Time will tell the extent to which this will last. In times past this would be regarded as the 'hard market' and as profits return companies would start looking for market share. Whilst there have been some brief signs of this occurring these have not lasted.

This time there could be a difference. The soft market will eventually emerge, it is a worldwide phenomenon. Australia has always had the dubious distinction of going much lower (softer) than other markets and their downward trend lasting longer than the rest of the world.

## **The Future**

It is reasonable to conclude that the environment for public liability now appears to be under control and the new APRA database will provide a good central source for reliable data. Premium levels will not drop as the market back at 2000 was suffering from 10 years of underpricing. The future will bring a small but consistent increase each year in line with inflation and the increase in damages awards. The hope and expectation this time is for a

market that will be sustainable and stable. With the market consolidation and a reinvigorated regulator this is entirely possible.

### **Further research**

This paper has examined the cause and outcome of the 'Liability crisis'. The reforms implemented incorporate many measures that should reduce losses and, it is hoped, produce a more stable liability insurance market. The thought lingers as to whether these reforms are simply a 'bandaid' for the problem and that what is needed is a radically different approach.

The principal problem area is the personal injury losses. This brings back the thought of a national compensation scheme. Such a scheme was introduced in New Zealand in the 1960's and was explored in Australia in the 1970's. It may be time to once again examine such a scheme.

These schemes are not perfect but the question is can they produce a more stable and equitable situation than exists at present? The area needs to be researched in some detail examining benefits and problems with such schemes that are currently in operation and examining the feasibility of introducing them to Australia. It is only by examining alternatives that the best, not necessarily perfect, arrangement can be achieved.

## References

APRA, 2001, *Selected Statistics on the General Insurance Industry, For Year Ended June 2001*, APRA, Canberra

APRA, 2000, *Selected Statistics on the General Insurance Industry, For Year Ended June 2000*, APRA, Canberra

APRA, 1999, *Selected Statistics on the General Insurance Industry, For Year Ended June 1999*, APRA, Canberra

APRA, 1998, *Selected Statistics on the General Insurance Industry, For Year Ended June 1998*, APRA, Canberra

APRA, 1997, *Selected Statistics on the General Insurance Industry, For Year Ended June 1997*, APRA, Canberra

Australian Competition and Consumer Commission, (ACCC) *Insurance Industry Market Pricing Review*, Report 1 – 4 2002 - 2004

Australian Injecting and Illicit Drug Users League (AIIDUL) Submission to Senate inquiry. 2002

Coonan, Senator H, *Reform of Liability Insurance Law in Australia* , February 2004

ICA, *Public liability submission to Ministerial forum*, Insurance Council of Australia, March 2002

Matheson, S., *Is the liability insurance crisis over?* ANZIIF Journal vol 27 No.2 April/May, 2004

McCarthy P, *Industry Profitability – A Brave New World*; Institute of Actuaries of Australia, Thirtieth General Insurance Seminar, November 2001.

Senate, *A Review of Public Liability and Professional Indemnity Insurance*, Economic References committee, The Senate, Canberra, October 2002

Trowbridge Consulting Limited, *Public Liability Insurance Analysis for Meeting of Ministers* 27 March 2002